

IRS Changes Policy on Taxability of German "Kindergeld"

by Steve Smith



I have good news to report for military taxpayers who receive German *Kindergeld*. The IRS Office of Chief Counsel, in a memorandum dated July 21, 2010, determined that *Kindergeld* is not income for U.S. federal income tax purposes. Why is that good news? Read on.

Kindergeld (i.e., child allowance) is an extremely valuable benefit if you qualify for it. My colleague, Joerg Modellmog, wrote an article on "How to Apply for German *Kindergeld*" in the Spring 2009 edition of this newsletter, in which he outlined who qualifies for the benefit. Persons employed on the German economy qualify for *Kindergeld*, as long as they pay into the German social security system. And if a dependent spouse happens to be a German or a citizen of another EU member country, he or she does not even have to work in order to qualify for *Kindergeld*. They just have to have kids.

How much *Kindergeld* you receive a month from the German government depends on how many *Kinder* you have. Currently, parents receive 184 Euros a month per child for their first and second child. They receive 190 Euros a month for a third child, and 215 Euros a month for a fourth, fifth, or sixth child, and so on. That can really add up!



The German government pays this allowance to encourage the creation of a new generation of taxpayers to help support the aging German population. Germany has never taxed *Kindergeld*—to do so would defeat the purpose of the incentive. But for years, the IRS took the position that, on American tax returns, *Kindergeld* was taxable income that had to be reported on line 21 of Form 1040 as "Other Income." The reason for this was simple. The Internal Revenue Code defines "income" as "all income from whatever source derived," and, unless there is an exception under the Code (as there is for gifts, inheritances, and certain insurance payments) whatever increased your wealth was taxable. There was no exception for German *Kindergeld*. Indeed, there was a time when military taxpayers in Germany were audited to see if they had included the *Kindergeld* in their taxable income. That being the case, military tax assistance centers routinely included questions about *Kindergeld* on their intake sheets, and advised taxpayers to include *Kindergeld* in their income.

All this began to change a few years ago when the IRS Attaché's Office at the Frankfurt Consulate began advising taxpayers that *Kindergeld* was not taxable, because it was analogous to a welfare payment. As a result, some tax assistance centers stopped including it in income, some stopped asking about it on their intake sheets but would include it if the taxpayer brought it up, and others took the position that until we had something in writing saying it was not taxable, the most prudent course of action (given the prior auditing practices) was to continue to include it in income. Taxpayers got different advice depending on which tax center they went to for tax preparation assistance. This was unacceptable, and led the IRS Attaché to request a formal opinion from the IRS Office of Chief Counsel on the taxability of *Kindergeld*.

What if you have been including *Kindergeld* in your taxable income and paying tax on it all along? The good news is, you can amend your 2007, 2008, and 2009 returns to delete that income, and request that the tax you paid on it be refunded. Our tax assistance centers will prepare amended returns for you, as long as you bring us a copy of your original return and its supporting documents. **Note that the last day you can amend a 2007 return is April 15, 2011 (three years from the due date of your 2007 return). So if you want to amend for 2007, you need to move fast!** Our tax centers have copies of the Chief Counsel's opinion to attach to the amendments as supporting authority.

Tune in for our next AFN Radio Open-Line tax call-in show on Wednesday, March 30th, at 1000 hours, at 1107 on your AM dial!